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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1946

No. 645 and 646

THE NEW YORK, CHICAGO & ST. LOUIS RAILROAD COMPANY

Appellant,

vs.

COMMONWEALTH OF PENNSYLVANIA

BRIEF FOR APPELLANT

IN OPPOSITION TO MOTION TO DISMISS OR AFFIRM

I

Reference to the Official Report of the Opinion Delivered in the Court Below.

Two cases involving essentially the same questions were argued together in the Supreme Court of Pennsylvania and one opinion covering both cases was handed down by that Court. This opinion is reported at No. 354 Pa. 355, 47A (2d) 272. An appeal to this Court was taken from the judgments in both cases, in each of which a Motion to Dismiss or Affirm and a Statement Opposing Jurisdiction were filed. This brief is filed in opposition to the Motion and the Statement in both cases.

II

A Concise Statement of the Grounds on which the Jurisdiction of the Supreme Court of the United States Is Invoked.

This already appears in the Statement as to Jurisdiction already filed in this case and is not here repeated.

III

A Concise Statement of the Case

On April 17, 1944, The New York, Chicago and St. Louis Railroad Company filed with the Court of Common Pleas of Dauphin County, two appeals from Orders of the Board of Finance and Revenue of Pennsylvania denying petitions for review of settlements of the Corporate Loans Tax for the year 1937 and for the year 1941 in the sum of $40,972.86 and in the sum of $26,865.41 respectively, on securities issued by the Railroad Company. A number of issues not pertinent here are raised in the appeals to the Court of Common Pleas of Dauphin County. The issue here is contained in Paragraph 5 of the respective Specifications of Objections of the appeals to the Dauphin County Court, and complains of tax settled at the rate of eight mills for one year on $795,000 par value for 1937 and on $456,000 par value for 1941 of appellant's securities held by mutual savings banks without capital stock incorporated in Pennsylvania, resulting in violation of Section 1, Article IX of the Constitution of the Commonwealth of Pennsylvania requiring uniform taxation, and in arbitrarily and capriciously depriving the appellant of property without due process of law, in violation of the Fourteenth Amendment of the Constitution of the United States, and impairment of contract in violation of Article I, Section 10, Clause 1 of the Constitution of the United States. The Corporate Loans Tax in Pennsylvania is a tax levied upon bonds and other securities and evidences of debt held by residents of Pennsylvania and issued

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or the payment assumed by Pennsylvania Corporations and by corporations doing business in Pennsylvania. The basic Act imposing the tax was enacted in 1885. From 1891 until 1935 it was a four mill tax upon the par value of the bonds. In 1935 an Act was approved adding an additional mill, and in 1936 this Act was amended to add four mills instead of one mill, making the total tax eight mills. The Act under which the 1941 tax was assessed was adopted in 1937, amended in 1939, and continued the eight mills of tax.

The tax is assessed and collected by the Treasurer of the corporation at the time interest is paid. If no interest is paid no tax is assessed or collected. By the decision of the Supreme Court of Pennsylvania in these cases the corporation is construed to be the assessor and collector of the tax and this construction is not here questioned.

By the Act of the Commonwealth of Pennsylvania, approved May 1, 1909, P.L. 198, mutual savings banks without capital stock were added to the exempt classes of holders of otherwise taxable securities and evidences of debt with the proviso: "and if at any time, either now or hereafter, any persons, individuals or bodies corporate have agreed or shall hereafter agree to issue his, their or its securities, bonds or other evidences of indebtedness clear of and free from the said four mills tax, herein provided for, or have agreed or shall hereafter agree to pay the same, nothing herein contained shall be so construed as to relieve or exempt him, it or them from paying the said four mills tax on any of the said such securities, bonds, or other evidences of indebtedness, as may be held, owned by or owing to said savings institution having no capital stock."

The obvious purpose of this proviso was to continue in force the obligation of the corporation issuing the bond to pay the tax which it had agreed to pay for the taxpayer. The holder of the bonds was exempted. The issuer of the bonds continued to

pay the holder's tax. "A's" tax was imposed upon "B". The debtor had to pay the creditor's tax from the payment of which the creditor had been excused.

Since, however, the Corporate Loans Tax had been and still is uniformly held by the courts of Pennsylvania to be a tax upon property (Commonwealth of Pennsylvania v. Lehigh Valley Railroad Company, 104 Pa. 89; Commonwealth v. Lehigh Valley Railroad Co., 186 Pa. 235, 246, 40 A. 491, 492; In re Wyoming Valley Ice Co., 145 F. 267; Commonwealth v. Jessup & Moore Paper Co., 31 Dauph. 273; Commonwealth v. Safe Harbor Water Power Corporation, 43 Dauph. 415; Appeal of Fidelity-Philadelphia Trust Company, 354 Pa. 355, 47 A. (2d) 267) both the lower Court and the Supreme Court of Pennsylvania in the case of **Commonwealth v. Lehigh Valley Railroad Co., 244 Pa. 241, 90 A. 564**, did not accept the obvious purpose of the proviso. Instead they held that the tax remained upon the tax-free covenant bonds in the hands of mutual savings banks without capital stock in Pennsylvania, while exempting bonds in the hands of mutual savings banks without capital stock, which did not contain such covenant. Thus, the mutual savings banks without capital stock held two classes of bonds, one taxable and the other not taxable. The obligation of the corporation to pay the tax referred to in the proviso, was its obligation as collector of the tax for the Commonwealth, and not the obligation imposed by its covenant. The covenant merely tagged the bond for classification. Since the tax remained on the bond, the covenant to pay the tax was kept active.

The amendment and proviso provided for in the Act of 1909 continued in force until 1937 when the proviso was amended to read as follows:

> "and if at any time either now or hereafter, any persons, individuals, or bodies corporate have agreed or shall hereafter agree to issue his, their or its securities, bonds or

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other evidences of indebtedness, clear of and free from the tax, **or any part thereof,** provided for in this act, or in the act approved the seventeenth day of June, one thousand nine hundred thirteen (Pamphlet Laws, five hundred seven), or have agreed or shall hereafter agree to pay the same, nothing herein contained shall be so construed as to relieve or exempt him, it or them, **from paying the tax imposed herein** on any of such securities, bonds, or other evidences of indebtedness, as may be held, owned by, or owed to, the said savings institution having no capital stock;" Act of May 18, 1937, P. L. 633.

It will be noted that the wording of the amended proviso conforms with the interpretation put upon it by the Supreme Court of Pennsylvania in Commonwealth vs. Lehigh Valley Railroad Company, supra.

Certain corporations in their covenants limited the amount of tax they would pay to four mills, while other corporations placed no limit on the amount of Corporate Loans Tax they would pay on behalf of the holder of the bonds. When the Act of 1936 was passed adding four mills to the four mills already imposed, the Commonwealth, under the construction placed upon the Act by the Supreme Court of Pennsylvania requiring the corporations which agreed to pay only four mills of such tax to collect the additional four mills from the mutual savings banks without capital stock, should have collected from mutual savings banks the additional tax on bonds with tax-free covenants. This the Commonwealth refused to do and limited the payment of the tax on such bonds to the four mills which the corporations had agreed to pay. This policy of the Commonwealth was continued under the Act of 1937 and its amendments.

Because the appellant had a covenant to pay whatever tax might be imposed, the Court of Common Pleas of Dauphin County in the instant case sustained in full the eight mills of

tax imposed on appellant's securities held by mutual savings banks without capital stock containing tax-free-covenant clauses. In both cases it dismissed the attack on the constitutional validity of the proviso imposing the tax on the authority of the case of Commonwealth vs. School District of Pittsburgh, 343 Pa. 394, 23 A. (2d) 496, which had upheld the authority of the earlier case of Commonwealth vs. Lehigh Valley Railroad Company, supra.

The appellant took an exception in both cases to this conclusion of the Court of Common Pleas of Dauphin County as follows:

> "9. The learned trial judge erred in failing to conclude that the imposition of liability upon the defendant to pay over the corporate loans tax involved in this case unconstitutionally deprived the defendant of its property without due process of law and denied to it the equal protection of the law."

The appellant also took exception in both cases to the finding of the trial judge that the defendant was liable for the tax on its tax-free covenant bonds held by Pennsylvania mutual savings institutions having no capital stock. The appellant also took exception to the judgment of the trial judge sustaining settlement of the tax. All exceptions were overruled. The overruling of the exceptions was assigned as error in the appeals taken to the Supreme Court of Pennsylvania. It sustained the judgments of the Court of Common Pleas of Dauphin County in the matter here involved as well as on other points. As to the constitutional validity of continuing the tax on tax-free-covenant bonds of the appellant held by mutual savings banks without capital stock, it contented itself with referring to the two cases in which the point had already been settled, — **Commonwealth vs. Lehigh Valley Railroad Co.**, supra, and **Commonwealth vs. Pittsburgh School District**, supra.

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It is the contention of The New York, Chicago and St. Louis Railroad Company that:

1. The continuing in force of the obligation of the appellant below under the tax-free covenant clauses in bonds held by mutual savings banks without capital stock compels appellant to pay a tax on property not owned by it but owned and held by mutual savings banks without capital stock, thereby depriving appellant of its property without due process of law and denying to it the equal protection of the law contrary to the Fourteenth Amendment of the Constitution of the United States.

2. The construction of the proviso of the taxing statute by the Supreme Court of Pennsylvania whereby bonds, securities and other evidences of debt held by mutual savings banks without capital stock are placed in two classes, — those containing no tax-free covenant clauses and those containing tax-free covenant clauses — is arbitrary and capricious classification in that while non-tax-free-covenant bonds in the hands of mutual savings banks without capital stock are exempt from tax, tax-free covenant bonds continue to be subject to tax solely for the purpose of keeping active for the benefit of the Commonwealth, a covenant which existed only for the benefit of the holder of the bonds. The appellant below is thereby denied the equal protection of the law and deprived of property without due process of law, contrary to the Fourteenth Amendment of the Constitution of the United States.

IV.

Specification of Such of the Assigned Errors as Are Intended to Be Urged.

It is intended to urge all of the assigned errors.

V.

Argument

This brief is filed in opposition to the "Motion to Dismiss or Affirm" and to the "Statement Opposing Jurisdiction" filed in these cases by the Commonwealth of Pennsylvania, the appellee. In both cases the Motion and the Statement are identical.

The Commonwealth of Pennsylvania in its Statement Opposing Jurisdiction makes its first ground of opposition the construction by the Supreme Court of Pennsylvania of the Act of May 1, 1909, P. L. 298. As so construed, the Act exempts bonds without tax-free covenant clauses in the hands of mutual savings banks without capital stock from the corporate loans tax of Pennsylvania, but continues the tax on bonds with tax-free covenant clauses in the hands of mutual savings banks without capital stock. The Supreme Court of the United States is bound by this construction. The question is whether the statute as so construed deprives the appellant of rights secured by the Federal Constitution. Under such circumstances this Court does not look to the form in which the taxing scheme is cast or to the characterization of that scheme as adopted by the State Court. The operation and effect of the tax, the substance and not the form is considered. St. Louis Southwestern Railway Company vs. Arkansas ex rel. Norwood, 235 U. S. 350, 362, 363, 35 S. Ct. 99, 59 L. Ed. 265; Senior vs. Braden, 295 U. S. 422, 429, 55 S. Ct. 800, 79 L. Ed. 520; Schuylkill Trust Co. vs. Commonwealth of Pennsylvania, 296 U. S. 113, 119, 56 S. Ct. 31, 80 L. Ed. 91.

It is observed that the Act of 1909 did not set forth in so many words the construction given it by the Pennsylvania Courts. It merely provided that for bodies corporate which had agreed or would thereafter agree to issue its securities clear of

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and free from the four mill tax therein provided for or with covenant to pay the same, nothing in the Act should be so construed as to relieve them from paying the said four mills tax on any of such securities owned by a mutual savings institution having no capital stock despite the exemption granted these institutions.

Obviously the Court could not construe the Act to mean that the mutual savings banks were exempt from paying the tax on corporate bonds held by it, while tax-free covenant clauses in such bonds would continue to bind the covenantors. That would mean that the debtor would continue to have to pay the creditor's tax, although the creditor was exempt from the tax. The debtor had only agreed to pay such tax as might be levied against the creditor. The State was not in privity with such a contract and could not enforce it against the debtor. Nehalem Timber & Logging Co. vs. Columbia County, 97 Ore. 100, 189 P. 212; Brewer vs. Davidson, 195 Okla. 654, 163 P. (2d) 987. Nor on the face of things is the State a third party beneficiary.

Such construction would reduce the statute to an attempt on the part of the State to tax "B" for the property owned by "A". By virtue of the exemption there was no further obligation on the part of the issuer of the bonds to pay the tax, and no one could collect from it unless the State had the naked power to keep alive a covenant to pay a tax which by its terms had become dormant. The exercise of such naked power comes down to the taxing of "B" for the property of "A". It has been settled that the State cannot do this. Schlessinger vs. State of Wisconsin, 270 U. S. 230, 70 L. Ed. 557, 46 S. Ct. 260; Hoepfer vs. Tax Commission, 284 U. S. 206, 76 L. Ed. 248, 52 S. Ct. 120; Heiner vs. Donnan, 285 U. S. 312, 76 L. Ed. 772, 52 S. Ct. 358.

The dissents in the cases just cited did not in any way attempt to deny the rule that the State could not collect tax against "B"

on property owned by "A". That proposition has never been doubted.

The Supreme Court of Pennsylvania did not take this obvious but unconstitutional construction. In order to avoid it, it fell back upon the power of the State to classify objects of taxation. As stated above, it held that the mutual savings banks without capital stock held two classes of corporate bonds, one with tax-free covenants and one without tax-free covenants. Commonwealth v. Lehigh Valley Railroad Co., 244 Pa. 241, 90 A. 564. The effect of this was to continue the obligation of the issuing corporation to pay the tax, since the tax still obtains on the class of bonds which have a tax-free covenant clause. The Pennsylvania Courts see no objection to this since all members of the class who hold the bonds, to-wit, mutual savings banks without capital stock, are treated alike. There is no discrimination.

But the point the appellant wishes to urge is that this is not a question of discrimination within a class. It is a question of using classification so as to tax "B" for property held by "A". It is the sole purpose of the classification and therefore arbitrary and capricious. There is the contrary of a reasonable basis for the classification. It is submitted there is a substantial question presented.

Highlighting the arbitrary and unreasonable purpose of the classification is the action of the tax officials of Pennsylvania taken when the millage of the corporate loans tax was raised from four to eight mills. The Act of June 17, 1913, P. L. 507, as supplemented by the Act of July 17, 1936, P. L. 51, under which the 1937 tax of eight mills was assessed, continued the restriction on the exempt bonds held by mutual savings banks which prevailed when the tax was four mills, and in so doing said: "If at any time either now or hereafter . . . bodies corporate have agreed or shall hereafter agree to issue . . . its

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securities . . . clear of and free from the said four mills tax herein provided for, or have agreed or shall hereafter agree to pay the same, nothing herein contained shall be so construed as to relieve or exempt . . . it . . . from paying the said four mills tax on . . . such securities . . . as may be held, owed by or owing to the said savings institutions having no capital stock."

The record shows that where the covenants of the bonds limited the payment of the tax to four mills, only four mills was collected while on bonds having covenants agreeing to pay all the tax, eight mills was collected.

The technical application of the Act would either apply to no bonds whatsoever since there was no four mills tax in 1937, or would at least relieve the bonds with an unlimited tax covenant clause from any tax. The next year the Act of May 18, 1937, P. L. 633 (amended by the Act of May 5, 1939, P. L. 46) under which the 1941 tax was assessed, corrected the defect in the 1936 Act by providing that "if at any time either now or hereafter . . . bodies corporate have agreed or shall hereafter agree to issue . . . its securities . . . clear of and free from the tax, or any part thereof, provided for in this Act, or in the Act approved the seventeenth day of June one thousand nine hundred and thirteen (Pamphlet Laws 507), or have agreed or shall hereafter agree to pay the same, nothing herein contained shall be so construed as to relieve . . . it . . . , from paying the tax imposed herein on any of such securities . . . , as may be held, owned by, or owing to the said savings institutions having no capital stock."

It is a serious question if the 1937 Act went so far as to affect taxes imposed for the year 1937. They were imposed under the Acts of 1913 and 1936.

There is no question, however, that in 1941 all bonds with tax-free covenants held by mutual savings banks without cap-

ital stock were taxable in the hands of the mutual savings banks under the wording of the 1937 Act and its amendment. Such of those bonds which limited assumption of the tax to only four mills of the tax left the mutual savings banks to pay the other four mills of tax. It was the duty of the Corporation issuing such bonds to deduct the additional four mills from interest paid to the mutual savings banks. This it did not do either in 1937 or in 1941 because of the ruling of the tax officials of Pennsylvania, that only four mills of tax was payable in such cases. Therefore, in the class of tax-free covenant bonds held by mutual savings banks, the Commonwealth failed to observe the tax statute requiring the collection of the full eight mills when the covenant limited the assumption of tax to four mills and discriminated against bonds with unlimited covenants by assessing the covenantor for eight mills of tax. Within the class itself those bonds with covenants limiting payment of tax to four mills were placed in an advantageous position over those with unlimited covenants.

It is further significant that as to nine other classes of institutions exempt from the assessment of the loans tax upon bonds in their possession, this exemption has no restricting proviso but is full and complete itself.

The second ground of the Commonwealth of Pennsylvania given in the Statement Opposing Jurisdiction contends that the exemption is inextricably integrated with the proviso limiting it and falls if the proviso falls. If the proviso is unconstitutional, the exemption is also unconstitutional; and the issuer of the bonds in the hands of mutual savings banks without capital stock is still bound by his covenant and therefore not hurt if the proviso is unconstitutional. This places the appellant in a position of not being able to complain of the unconstitutionality of the proviso.

It should be noted that the Pennsylvania Court does not in

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Commonwealth v. Lehigh Valley Railroad, supra, nor in any other of its opinions on the question state that the legislature would not have exempted the bonds unless the exemption were modified by the proviso. True it is that it does say that the exemption and proviso must be read together; that the intention of the legislature was to favor savings institutions, and not to benefit the issuing corporations; and that the legislative intention was to retain the tax. It is significant that it does not go on to say that there would have been no exemption without the proviso.

Undoubtedly the exemption standing alone would be constitutional. Mutual savings banks are of such a character as to warrant exemption. They held $1,086,920,135.40 of assets as of June 30, 1946 and were founded for the benefit of people of few means. They had as of June 30, 1946, 1,164,186 depositors. The safeguards thrown around them, their co-operative characteristics, the return they give their depositors and other features make them a special regard of the State. They are of a piece with mutual fire and life insurance companies which are exempt from tax without proviso attached. That the proviso attached to the exemption of mutual savings banks would be unconstitutional, does not of necessity mean that the exemption itself is unconstitutional. It could stand on its own feet. To assert that the legislature meant that the proviso, if unconstitutional, should also render the exemption unconstitutional is a mere speculation for which there is no basis in the record, in the opinions of the Courts below or in the law. The legislature may have wished to retain the tax, but it does not appear that it wished to retain the tax at the expense of the exemption. The Commonwealth cannot postulate the argument that the exemption falls with the proviso as the conclusion of the Pennsylvania Courts at this stage of the proceedings.

The third ground of the Commonwealth of Pennsylvania

given in the Statement Opposing Jurisdiction has been answered already in discussing the first and second grounds, except where the Commonwealth states that if the exemption were extended to bonds of corporations which had assumed the payment of taxes there would be discrimination against bonds of corporations which did not happen to be held by savings institutions. There are nine other classes of exempt institutions provided for in the Act. If any one of these institutions did not hold bonds of certain corporations, then, following the argument of the Commonwealth, those corporations are discriminated against and the exemption is unconstitutional. In order to retain their exemption, the exempt institutions would have to hold bonds of all corporations in order not to discriminate against any. The absurdity of the proposition is evident. The constitutionality of the other classes of exempt holders has never been questioned and a fortiori the exemption of mutual savings banks without capital stock of itself would stand.

It is therefore respectfully submitted that real and substantial questions are presented in this case and that the Supreme Court of the United States has jurisdiction thereof.

Robert M. Fisher,
John Y. Scott,
Counsel for The New York, Chicago and St. Louis Railroad Company.

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APPENDIX

Motion to Dismiss or Affirm

Now comes the Appellee, the Commonwealth of Pennsylvania, and moves that the appeal in the above case be dismissed on the ground that the case presents no substantial Federal question, and it further moves that, if the motion to dismiss be not granted, this Court affirm the decision of the Supreme Court of Pennsylvania on the ground that the questions on which the decision of this cause depends, are so unsubstantial as not to need further argument. In support of this motion the Appellee advances the reasons set forth in the statement opposing jurisdiction filed in connection with this appeal.

COMMONWEALTH OF PENNSYLVANIA
By:

George W. Keitel,
Deputy Attorney General.
James H. Duff,
Attorney General.

Statement Opposing Jurisdiction

Now comes the Appellee, the Commonwealth of Pennsylvania, and submits herewith its statement of reasons why the above-entitled case presents no substantial Federal question so as to justify the jurisdiction of the Supreme Court of the United States, as asserted by the Appellant.

1. The appeal from the judgment of the court below sustaining the imposition of the corporate loans tax of Pennsylvania presents no substantial question. Appellant's Assignment of Errors discloses that the sole ground for appeal is the alleged invalidity of the provision in the Pennsylvania Corporate Loans Tax Act exempting securities held by mutual savings banks without capital stock, as modified by the proviso that

securities containing tax-free covenants are subject to the said tax. As long ago as 1914 the Supreme Court of Pennsylvania has construed the said proviso as being "intended to preserve the tax on corporate securities owned or held by savings institutions which had no capital stock, where in and by the securities themselves the institutions were already relieved, and needed no legislative exemption": **Commonwealth v. Lehigh Valley Railroad Company,** 244 Pa. 241, 90 A. 564 (1914). This construction of the proviso was concurred in by the Supreme Court of Pennsylvania as recently as 1942 in **Commonwealth v. School District of Pittsburgh,** 343 Pa. 394, 23 A. (2d) 496 (1942). Under such interpretation of the tax statute by the Supreme Court of Pennsylvania, no substantial Federal question can be raised.

2. Since the said proviso merely limits the exemption and is inextricably integrated with it, it could not be unconstitutional unless the exemption were unconstitutional. Even if the exemption were unconstitutional, the Appellant herein would have to pay the tax on the securities involved in the present case. Therefore, the Appellant cannot be injured by the decision of the Supreme Court of Pennsylvania applying the tax to its securities: **Hermann Estate,** 349 Pa. 230, 36 A. (2d) 804 (1944).

3. It has been the policy of the Pennsylvania Legislature to exempt from taxation bonds held by savings institutions having no capital stock. When the corporation which issues such bonds undertakes to assume the payment of all taxes, the reason for the exemption disappears and the tax is ultimately paid by the corporation. This does not result in multiple classification. On the contrary, it preserves in the only manner possible the exemption in favor of savings institutions having no capital stock. If the exemption were to so overlap that it extended to the corporations which had assumed the payment of taxes when

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the bonds were issued, as Appellant contends it should, discrimination would exist against any such corporation which did not happen to have any bonds held by such savings institutions.

For the foregoing reasons, none of the questions raised on this appeal are of substance.

Respectfully submitted,

COMMONWEALTH OF PENNSYLVANIA
By:

George W. Keitel,
Deputy Attorney General.

Of Counsel for Appellee.